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PSC RULES ON KENTUCKY-AMERICAN WATER RATE REQUEST

Amount is less than company sought; customers will receive refunds

FRANKFORT, Ky. (Feb. 28, 2005) The Kentucky Public Service Commission (PSC) has granted Kentucky-American Water Co. a rate increase that is about half the amount requested by the company.

In an order issued today, the PSC also ordered Kentucky-American to refund to customers, with interest, excess revenue the company had collected in the three months since putting its proposed rates into effect on Dec. 1, 2004.

On April 30, 2004, Kentucky-American submitted a request to raise its annual revenues from water sales by about \$6.62 million. Kentucky-American also proposed to increase annual revenue by an additional \$672,000 through an account activation fee of \$24 that reflects the cost of turning on service and establishing an account.

In today's order, the PSC allowed an annual increase in revenue from water sales of \$3.61 million. The PSC also approved the account activation fee.

The rate increase will mean that the average Lexington-area residential customer using 5,000 gallons of water per month will see the monthly bill increase from \$22.14 to \$24.10, an increase of about 8.5 percent. The PSC said the increase was justified because Kentucky-American's costs of doing business have risen since the company's last rate adjustment nearly five years ago.

Because Kentucky-American chose to implement its proposed rates prior to the PSC's decision, it will have to refund to its customers the difference between the proposed rates and the approved rates for the last three months. A utility may put its proposed rates into effect if the PSC has not ruled on its rate application within six months, but must refund any excess revenue if the PSC ultimately approves rates lower than those imposed by the utility.

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The rate increase granted by the PSC was lower than the amount requested by Kentucky-American because of decisions made regarding a number of specific issues. Among those decisions were:

- Granting Kentucky-American a 10 percent rate of return on equity, rather than the 11.2 percent the company had requested. The PSC determined that the lower level is reasonable and in line with the return on equity for similar water utilities.
- Denying Kentucky-American's request to recover from customers more than \$2.8 million the company had already spent on increased security in the wake of the Sept. 11, 2001, terrorist attacks. The PSC noted that the company had agreed to absorb those costs as a condition of the Commission's approval in 2002 of the acquisition of Kentucky-American's parent company by RWE AG, a German company. The costs were incurred prior to the period used to calculate the new rates. However, estimates of future security costs are included in the new rates.
- Denying Kentucky-American's request to recover its allocated share of the costs involved in the parent company's consolidation of all of its North American accounting, billing, payroll and other financial functions at a center in New Jersey and the centralization of its customer call centers in Illinois. The PSC ruled that Kentucky-American had failed to prove the costs were reasonable and necessary and to demonstrate the benefits, if any, to its ratepayers.
- Rejecting Kentucky-American's request to have ratepayers bear the costs of incentive compensation plans for its management, professional and technical employees. Finding that Kentucky-American could not justify the reasonableness of the costs, the PSC ruled that shareholders should bear the annual cost of about \$229,000.
- Disallowing the amortization of the premium that Kentucky-American paid to acquire two small water systems in the Owenton area on the grounds that the company shareholders and not its ratepayers are the primary beneficiaries of the acquisitions. But the PSC noted that this decision does not represent "a retreat from our earlier pronouncements encouraging the development of regional water suppliers and the consolidation of smaller and less efficient water systems."
- Denying Kentucky-American's request to include in its rate base \$117,525 in annual business development costs on the grounds that they had not been justified.

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The PSC also ordered Kentucky-American to provide certain information to the Commission. The company is to track all costs and time devoted to fighting a condemnation action initiated by the Lexington-Fayette Urban County Government. Kentucky-American also is to report, within 60 days, on how it is affected by organizational changes within the parent company.

Kentucky-American serves more than 100,000 retail customers in Fayette, Bourbon, Clark, Gallatin, Grant, Harrison, Owen, Scott and Woodford counties. It provides wholesale water to the cities of Georgetown, Midway, Versailles and Winchester, and to the Harrison County and Lexington-Elkhorn water districts.

Today's PSC order and related documents in the case are available on the PSC Web site, psc.ky.gov. The case number is 2004-00103.

The PSC is an agency within the Environmental and Public Protection Cabinet. It regulates more than 1,500 gas, water, sewer, electric and telecommunication utilities operating in the Commonwealth of Kentucky and has approximately 110 employees.

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